WESTERN FUELS-UTAH, INC.

IBLA 89-191 Decided May 14, 1991

Appeal from a decision of the Colorado State Office, Bureau of Land Management, denying an application for royalty rate reduction for Federal coal leases C-023703, C-44693, and C-0126669, and waiver of rentals on those leases and three others, C-8424, C-8425, and D-047201.

Set aside and remanded.

1. Board of Land Appeals--Coal Leases and Permits: Rentals--Coal Leases and Permits: Royalties--Mineral Leasing Act: Rentals--Mineral Leasing Act: Royalties

Under 30 U.S.C. § 209 (1988), BLM is authorized to reduce the royalty rate and waive rentals for a coal lease for the purpose of encouraging the greatest ultimate recovery of Federal coal and in the interest of conservation of natural resources, if it determines either that such relief is necessary to promote development, or the Federal lease cannot be operated successfully under its existing terms. A BLM decision denying a royalty rate reduction and waiver of rentals may be set aside and remanded where that decision is based on BLM guidelines that do not address the unique circumstances of a not-for-profit, captive mine, which sells its entire production at cost to one of its owners, a not-for-profit electric generation and transmission cooperative, and which is an integral part of a rural electric power project financed by loans guaranteed by the Rural Electrification Administration, and
on appeal, the Board of Land Appeals determines that such circumstances are appropriate for consideration.

APPEARANCES: Richmond F. Allan, Esq., Washington, D.C., for Western Fuels-Utah, Inc.; Robert G. Holt, Esq., and Clayton J. Parr, Esq.,
Salt Lake City, Utah, for Deseret Generation & Transmission Co-Operative, intervenor; Terence M. Brady, Esq., Deputy Assistant General Counsel, U.S. Department of Agriculture, Washington, D.C., for the Rural Electrification Administration, amicus curiae. 1/

1/ By order dated Nov. 15, 1989, the Board granted Deseret Generation & Transmission Co-Operative's (DG&T's), motion to intervene in Western Fuels-Utah (WFU's), appeal and allowed the Rural Electrification Administration (REA), to appear as amicus curiae.

OPINION BY ADMINISTRATIVE JUDGE HARRIS

WFU has appealed from a November 23, 1988, decision of the State Director, Colorado State Office, Bureau of Land Management (BLM), denying its application for a reduction of the royalty rate for Federal coal leases C-023703, C-44693, and C-0126669, from 8 percent to 2 percent of value, and for a waiver of rentals on those leases and Federal coal leases C-8424, C-8425, and D-047201. These six leases comprise the Deserado Mine Logical Mining Unit and are located in Ts. 2 and 3 N., R. 101 W., sixth principal meridian, Rio Blanco County, Colorado.

Some background information from the record and briefs filed by the parties is necessary to explain the context in which this appeal arose.

WFU owns and operates the Deserado Mine, a private railroad, and related coal transportation facilities. All are part of the Bonanza Power Project. The other parts of that project are the Bonanza Power Unit, a coal-fired electrical generation facility located in eastern Utah near the city of Vernal, and related electrical transmission facilities, owned and operated by DG&T, a nonprofit generation and transmission cooperative which supplies power to six rural electrification associations serving consumers in six states.

WFU is a subsidiary of Western Fuels Association, Inc. (Western Fuels). Western Fuels is a nonprofit cooperative which supplies fuel to its membership of 13 rural electric cooperatives and 22 public bodies operating electric utility systems. WFU was organized for the sole purpose of owning and operating the Deserado Mine to supply coal to the Bonanza Power Unit. It delivers coal from the mine in Colorado by railroad to the Bonanza Power Unit in Utah. WFU is owned by DG&T (90 percent) and Western Fuels (10 percent).

Primary financing for the Bonanza Power Project was provided in 1981 by a $900 million dollar loan guaranteed by the REA, an agency of the U.S. Department of Agriculture, to DG&T. Pursuant to an October 28, 1981, funding agreement between DG&T and WFU, DG&T lent a portion of the proceeds from the guaranteed loan to WFU for the development of the Deserado Mine.

On October 28, 1981, DG&T and WFU also entered into a coal sales agreement. Under this agreement, DG&T pays WFU for coal at the cost of production and transportation. WFU also may collect from DG&T payments for a post-mining reclamation fund and a capital recovery and equipment replacement fund. However, WFU does not receive any profit or return on investment from the sale of its coal to DG&T.

On June 6, 1988, WFU, as owner and operator of the Deserado Mine, submitted to BLM the above-described application for royalty rate reduction and waiver of rentals on its Federal coal leases, pursuant to section 39 of the Mineral Leasing Act (MLA), as amended, 30 U.S.C. § 209 (1988), 43 CFR 3473.3-2(d) (1988) (now found at 43 CFR 3473.3-2(e)) and 43 CFR 3485.2(c). WFU sought a reduction and waiver in accordance with category 3 - "unsuccessful operations" - of the June 1987 BLM final guidelines for reduction

of royalty rate for solid leasable minerals. 2/ Analysis of category 3 applications under the guidelines focuses solely on the economic viability of the mining operation standing alone. See BLM Manual, § 3485.23F.2. 3/

A BLM coal royalty reduction evaluation team reviewed WFU's applica-tion in accordance with the royalty reduction guidelines. 4/ It analyzed the information submitted by WFU, as well as additional data supplied by
the Minerals Management Service and BLM's Craig District Office. The team found that the Deserado Mine was an extremely efficient longwall operation. It acknowledged that (1) the mine was the dedicated fuel supplier for DG&T's Bonanza Power Unit; (2) under existing financing arrangements the mine, power plant, connecting railroad, and power lines were considered one project operated by DG&T and funded primarily through the REA; and (3) DG&T reimbursed WFU for its costs and capital expenditures, but, under its char-ter, WFU could not generate a profit. The team also noted that WFU had decided to forego billing DG&T for contributions to a capital recovery and replacement fund until the current economic hardships lessened.

The team concluded that royalty reduction was not needed to allow WFU to successfully operate the leases. It found that WFU's coal sales price was not unreasonably high, its operating costs were not excessive, and all its costs were fully reimbursable under the coal sales agreement. The team determined that the leases could be successfully operated under the exis-ting royalty and that WFU's losses could be eliminated by billing DG&T for the full amount allowed by its agreements with DG&T. It stated that WFU's choice to forego full compensation should not affect its royalty rate.

The team also determined that WFU had not demonstrated that granting the royalty rate reduction was necessary to insure the ultimate recovery
of the coal. It found that WFU's information did not establish that there existed a reasonable probability that the Deserado Mine would close if the relief was not granted, and indicated that, in any event, the remaining reserves were large enough to support another operation should the mine

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2/ Notice of the availability of those guidelines was published in the Federal Register on June 30, 1987. In that notice, BLM explained that the guidelines provided the requirements that a lessee had to meet to qualify for royalty relief and the evaluation and approval criteria BLM had to employ in analyzing applications for royalty rate relief. See 52 FR 24347 (June 30, 1987). These guidelines, as they relate to coal leases, are now found in section 3485.23 of the BLM Manual. The guidelines do not set forth any criteria for waiver of rentals.

3/ BLM Manual section 3485.23F.2a requires that applications under cate-gory 3 "must present lease operating-cost and revenue data that show the mine to have operated at a loss for the most recent historic 12-month test period." (Emphasis added.)

4/ In a handwritten summary dated Aug. 8, 1988, one of the team members recognized that this case was complicated by the fact that the guidelines did not address captive, not-for-profit arrangements such as the one presented here.

close. Therefore, the team rejected WFU's assertion that the coal would be permanently lost if the royalty rate reduction were not approved, and recommended that the application for royalty rate reduction and waiver of rentals be denied. 5/

In his November 23, 1988, decision, the Colorado State Director denied WFU's request for royalty rate reduction and waiver of rentals. He concluded:

> The lessee has failed to demonstrate that the leases cannot be operated successfully under their existing terms. Lessee has long-term funding and coal sales agreements which provide for full compensation for all costs of development, production, and reclamation. Current losses are due solely to the lessee's agreement not to collect all monies due under the funding agreements. [6/]
>
> The lessee has also failed to demonstrate that a royalty reduction would encourage the greatest ultimate recovery of the coal. There is no evidence that current recovery rates would increase as a result of a reduction. Neither is there evidence that federal coal resources would be irrevocably lost absent the granting of a reduction. The requests for royalty rate reduc-tions are therefore denied.
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> Waiver of rentals is denied because the lessee has failed to address the question of whether a reduction is necessary to promote development and has failed to demonstrate that the leases

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5/ In an Aug. 12, 1988, memorandum transmitting a draft denial decision and the team's report to the Director, BLM, for his policy review, the Colorado State Director indicated that this case was unusual

"not only because the mine is owned and operated by its customer, but in that the mine/power plant project is owned by an association of rural electric cooperatives who obtained federal funding and loan guarantees to construct the project. Therefore, the federal government is the ultimate beneficiary or victim of the project's success or failure."

The State Director stated his belief that this situation was not adequately covered by the guidelines and suggested that consideration be given to expanding existing guidance or developing alternative methods to evalu-ate the need for royalty relief in these types of situations. Although in an Oct. 11, 1988, memorandum, the Director, BLM, concurred with the proposed denial, he did not respond therein to the State Director's comments.

6/ We note that the funding agreement between DG&T and WFU established the conditions under which DG&T would lend funds to WFU for the development of the Deserado Mine in order to secure a coal supply for the Bonanza Power Unit; it did not set the compensation DG&T would pay for the coal. The coal sales agreement, not the funding agreement, determined the amount due for the coal.

cannot be successfully operated under their existing terms as explained above.

(Decision at 1-2).

On appeal, WFU repeats the justification for its royalty rate reduc-tion and rental waiver request explained in its application, emphasizing
the integrated nature of all facets of the Bonanza Power Project, the financial condition of the project, the geographic isolation of the area, and the absence of any possible market for coal from the mine, except for the project. It argues that, if the project fails, not only will the coal reserves remain unrecovered, but the Government will suffer huge financial losses through defaults on the REA-guaranteed loans.

WFU submits that:

> [t]he State Director erred fundamentally in failing to appreciate the consequences of the fact that the Deserado is a captive mine, without utility apart from the Bonanza project of which it is an integral element. In undertaking to determine whether the mine can be successfully operated under the existing lease terms by looking at the mine in isolation from the project, he simply failed to come to grips with the most critical fact of the case. The mine is not an independent economic or operational unit and to undertake to analyze its condition as though it were is to fantasize. The indisputable facts that the Bonanza project cannot be successfully operated for the time being at its current levels of cost and that successful operation of the mine is entirely dependent upon the successful operation of the project belies the State Director's facile conclusion that the mine could be successfully operated if only WFU would insist upon its contract rights against [DG&T].

(WFU Statement of Reasons (SOR) at 9).

In a supplemental statement of reasons, counsel for WFU recounts the State Director's statement that "[c]urrent losses are due solely to the lessee's agreement not to collect all monies due under the funding agreements" (Decision at 1; see note 4, supra). Counsel states that the notion that WFU deferred collection of certain payments from DG&T was "carried
into" WFU's SOR (Supplement at 1). However, he asserts that he "is now advised that the proposition is not true; that, to the contrary, DG&T has always remitted all payments to which [WFU] is entitled under the contracts relating to the Bonanza Power Project, although the project as a whole has experienced losses." Id. at 1-2. He explains that the excess of costs over revenue shown on WFU's audited statement of operations for 1987 submitted with its application "is not attributable to [WFU] having deferred collection of any money owed by DG&T but to application of rules prescribed by
the BLM for accounting for certain items that are different from those prescribed by generally accepted accounting principles" (Supplement at 2). According to counsel for WFU, the audited statement shows that the costs

and revenues related to the mine are in balance when determined in accordance with generally accepted accounting principles. He further notes
that because DG&T is obligated to reimburse WFU only for the actual costs
of producing and delivering the coal, WFU could not defer the collection
of any monies owed by DG&T and continue to operate.

In its SOR, intervenor DG&T also argues that the State Director erred because he failed to consider the costs and revenues of the project as a whole. It contends that the statute and regulations are broad enough to encompass the financial analysis of all activities relating to lease operations, including mine, transportation, and electrical generating facility operations, when a not-for-profit project uses coal from a captive mine.

DG&T recognizes that the State Director felt constrained by the roy-alty rate reduction guidelines, which were designed for the typical situation of a stand-alone for-profit mine and do not consider the financial analysis required for a not-for-profit project with a captive mine. It argues that the guidelines cannot be more limiting than the statute and regulations which do not confine the analysis to the financial operations
of the mine, and that the Board, which is not bound by the guidelines, has the authority to require consideration of the financial status of the Bonanza Power Project as a whole.

DG&T further asserts that the State Director did not adequately consider all the Federal interests involved which include not only BLM's interest in maintaining a stream of royalty revenue from coal production, but also REA's interest in preventing defaults under the loans it guaranteed. Adherence to the initial royalty rate, it contends, would more adversely affect the Federal economic interest than would reduction of that rate. DG&T notes that the State Director did not address the interest of the Federal Government in his written decision, and argues that he erred in failing to consider those interests since royalty rate reduction and rental waiver would make a significant contribution toward preventing the failure of the Bonanza project and, thus, protect the Federal interest.

If the project is analyzed as a whole, DG&T submits, the facts clearly demonstrate that the leases cannot be operated successfully. While acknowledging that royalty rate reduction and rental waiver will not eliminate the losses experienced by the project, DG&T contends that they will contribute significantly to reducing those losses. It also argues that the facts show that royalty rate reduction and rental waiver are in the best interest of the Federal Government because the interests of both BLM and REA are best served by the continued operation of the power project.

In its amicus curiae brief, REA explains that it has financed most of the development of the Deserado Mine by guaranteeing loans made to DG&T to reloan to WFU under the REA-approved funding agreement. It argues that the State Director arbitrarily failed to consider the interdependent relationship between the mine and the Bonanza power plant, despite BLM's earlier

recognition of this relationship during its participation in the development of the Bonanza Power Project. 7/ REA asserts that DG&T's financial problems directly affect WFU and the operation of the mine, and that the State Director should have ignored the separate corporate structures of WFU and DG&T and focused instead on the economic viability of the Bonanza Power Project as a whole.

REA argues that section 39 of the MLA, 30 U.S.C. § 209 (1988), grants the Secretary broad discretion in granting rental and royalty rate relief, and that in exercising this discretion, the Secretary should be sensitive to all the interests of the United States that might be affected by the decision. It emphasizes that nearly $527,000,000 in loan guarantees in connection with the project remain outstanding and that the United States would be the loser if DG&T defaults on those loans. REA suggests that "[i]f the United States stands to experience a significant adverse impact from cessation or suspension of mining operations, apart from interruption of the revenue stream, that impact should be considered in determining whether relief should be granted under Section 39" (REA Brief at 10-11).

REA concludes that the interests of the United States would be best served if the requested royalty rate reduction and rental waiver are granted because such relief would assist in stabilizing the financially precarious position of the Bonanza Power Project and would lessen the likelihood that bankruptcy or forced liquidation of DG&T and WFU will
occur, thus avoiding greater economic harm to the United States. 8/

[1] Section 39 of the MLA, 30 U.S.C. § 209 (1988), provides the Secretary of the Interior with discretionary authority to grant waivers
of rental and reductions in production royalties:

> The Secretary of the Interior, for the purpose of encour-aging the greatest ultimate recovery of coal, * * * and in the interest of conservation of natural resources, is authorized
> to waive, suspend, or reduce the rental, or minimum royalty,
> or reduce the royalty on an entire leasehold, or on any tract
> or portion thereof segregated for royalty purposes, whenever
> in his judgment it is necessary to do so in order to promote development, or whenever in his judgment the leases cannot be successfully operated under the terms provided therein.

7/ Apparently the Utah State Office, BLM, granted rights-of-way and other land use authorizations for the power plant site and linear facilities and actively participated in the preparation of the environmental impact statement for the Bonanza Power Project. See, e.g., 46 FR 23996 (Apr. 29, 1981).

8/ No appearance has been made on appeal by the Solicitor's Office, on behalf of BLM, to answer the contentions of the parties or to argue in favor of the decision under appeal.

The Department's implementing regulations provide at 43 CFR 3473.3-2(d) (1988) (now 43 CFR 3473.3-2(e)):

> The Secretary, whenever he/she determines it necessary to promote development or finds that the lease cannot be success-fully operated under its terms, may waive, suspend or reduce
> the rental, or reduce the royalty but not advance royalty, on an entire leasehold, or on any deposit, tract or portion thereof, except that in no case shall the royalty be reduced to zero percent.

Additionally, 43 CFR 3485.2(c)(1) states that

> [t]he authorized officer may waive, suspend, or reduce the rental on a Federal lease, or reduce the Federal royalty, but not advance royalty, on a Federal lease or portion thereof. The authorized officer shall take such action for the purpose of encouraging the greatest ultimate recovery of Federal coal, and in the interest of conservation of Federal coal and other resources, whenever in his judgment it is necessary to promote development, or if he finds that the Federal lease cannot be successfully operated under its terms. In no case shall the authorized officer reduce to zero any royalty on a producing Federal lease.

Under the statute, a reduction of royalties and waiver of rentals must be for the purpose of encouraging the greatest ultimate recovery of Federal coal and in the interest of conservation of natural resources, and it must be based on one of two determinations: (1) that such relief is necessary to promote development, or (2) the Federal lease cannot be operated successfully under its existing terms. On the basis of the information submitted by the applicant, "BLM must be able to find there is a reasonable probability operations would cease or development, recovery, or conservation of the resource would be jeopardized before it can even consider exercising its discretion to grant relief." Peabody Coal Co., 93 IBLA 317, 327, 93 I.D. 394, 400 (1986). Additionally, "[t]he ultimate issue in the adjudication of any royalty reduction request is whether BLM may properly conclude, on the basis of the material submitted by an appellant, that granting a reduction would best serve the interests of the Government." Peabody Coal Co., supra at 321, 93 I.D. at 396; see also State of Wyoming, 117 IBLA 316, 321 (1991).

The State Director's conclusion that WFU had failed to demonstrate that the leases cannot be operated successfully under their existing terms was based on his finding that current losses were due entirely to WFU's failure to collect from DG&T all monies to which it was entitled. That finding has been challenged by WFU on appeal. WFU alleges that DG&T has always remitted all payments to which WFU is entitled, but that the project itself has operated at a loss since 1986. WFU, DG&T, and REA all argue that the unique circumstances presented here mandate that BLM analyze the financial condition of the entire project, not just the Deserado Mine, in evaluating WFU's

application and that consideration be given to REA's financial stake in the continued operation of the power project.

As we have stated in the past, BLM Instruction Memoranda and BLM Manual provisions, while binding on BLM employees, are not binding on this Board or on the general public. Beard Oil Co., 105 IBLA 285, 288 (1988); Pamela S. Crocker-Davis, 94 IBLA 328, 332 (1986); United States v. Kaycee Bentonite Corp., 64 IBLA 183, 214, 89 I.D. 262, 279 (1982). The record is clear that the BLM employees in the field who conducted the review of the application felt that the guidelines under which they were required to operate did not adequately cover situations such as the one here where a not-for-profit, captive mine is part of an integrated power project, the construction of which was financed through loans guaranteed by the Federal Government. See, e.g., August 12, 1988, memorandum to Director, BLM, from Colorado State Director, note 5, supra.

Under the singular circumstances presented here, we find that, given the Secretary's broad statutory and regulatory discretion, the guidelines established by BLM should not prohibit the Secretary from analyzing WFU's royalty reduction and waiver request in the context of the economic viability of the power project as a whole. Such analysis would best reveal whether granting the requested relief would be appropriate. For that reason, we are setting aside the BLM decision and remanding the case to allow reconsideration of WFU's application in light of the statutory and regulatory requirements, without restriction to the BLM Manual guidelines.

Although reconsideration of the application in light of the entire operation could affect the finding relating to successful operation of the leases under existing conditions, the State Director also denied the request for royalty rate reduction (as opposed to waiver of rentals) on the basis that WFU failed to show that reduction of royalty "would encourage the greatest ultimate recovery of the coal" (Decision at 1). On appeal, WFU has challenged that finding asserting that due to the geographic isolation of the leases, failure of the project would result in the coal subject to the leases never being mined. The State Director apparently relied on the finding of the evaluation team at page 7 of its report that "[w]e do not believe that the applicant has demonstrated such a probability [reasonable probability mine operations would cease if relief was not granted]. This operation is bound to the power plant. As long as the plant is in operation, it will obtain coal from this mine." (Emphasis added.) WFU's point is that without the relief the whole project will fail and there will be no market for the coal. If, on remand, BLM again determines that reduction and waiver would not encourage the greatest ultimate recovery of the coal, such a determination would preclude granting a reduction of royalty and waiver of rentals, even if WFU could establish that the leases could not be successfully operated under the existing terms.

On remand BLM may request any additional and updated financial and other information necessary to assist it in determining whether royalty rate reduction and rental waiver are proper in this case.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed is set aside and the case is remanded to BLM for further action consistent with this decision.

Bruce R. Harris
Administrative Judge

I concur:

Wm. Philip Horton
Chief Administrative Judge